India’s New Economic Policy

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The New Economic Policy July 1991 was a turning point in the Indian Economy. In place of the hitherto planned economy, Indian adopted market oriented strategies to deal with her massive economic problems. The New Economic Policy contains a) short term fiscal corrections: massive external borrowing, devaluation of Indian Rupee, cut in government expenditure and b) structural adjustments; de-emphasizing public sector, deregulation, decontrol and privatization of enterprises. The success of these measures would depend on important implicit assumptions and the trickle down effects of various policies to deal with the serious economic problems.

I. Introduction

Since independence, there have been some important turning points in the Indian economy; one such turning point occurred during the fifties when planning, planned economy, socialistic pattern of society were adopted as dominant philosophy underlying Indian economic policies. Then, the second turning point occurred during 1991, with the declaration of some crucial policy statements; de-emphasizing the objectives of planned economy of the fifties and adopting market oriented strategies. We will start with a brief review of the present state of the Indian economy based on its experience of four decades of economic planning. The essential of new economic policies announced in 1991 will then be analyzed contrasting them with the earlier economic strategies.

II. The Present State of the Indian Economy

During the year 1991-1992, the gross domestic product increased

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by only 1.2 percent; the lowest since 1980-81. The dominant factor in this low growth rate is stagnant industrial production and also decline of about 2.8 percent in the agricultural output. Taking a longer period of four decades: 1950-90, since the inception of the First Five Year Plan, the continuously computed rate of growth is estimated at 3.0 percent. However, with the population increase of 1.9 percent per year during the same period, increase in per capita income comes to a pit-tance annual figure of 1.1 percent. These macro figures on the growth of GDP and per capita income, as indicated in Table 1, are quite low judged from various standards e.g. growth achieved by several other developing economies; compared with the targeted rates of growth, and growth rates deemed essential for achieving various objectives of economic planning including provision of employment opportunities and reducing levels of poverty.

### Table 1

**SOME KEY ECONOMIC INDICATORS IN INDIA**

(Average Annual Growth Rates)

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<tbody>
<tr>
<td>Gross Domestic Product</td>
<td>3.0</td>
<td>5.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Population Growth</td>
<td>1.9</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Per Capital GDP&lt;sup&gt;a&lt;/sup&gt;</td>
<td>1.1</td>
<td>3.3</td>
<td>-0.6</td>
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<tr>
<td>Industrial Production</td>
<td>6.1</td>
<td>8.3</td>
<td>-1.0</td>
</tr>
<tr>
<td>Agricultural Production</td>
<td>2.6</td>
<td>2.7</td>
<td>-2.8</td>
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<tr>
<td>Foodgrain (million tons)</td>
<td>—</td>
<td>176.4</td>
<td>167.1</td>
</tr>
<tr>
<td>% Change over previous years</td>
<td>—</td>
<td>3.2</td>
<td>-5.3</td>
</tr>
<tr>
<td>Whole sale price index&lt;sup&gt;b&lt;/sup&gt;</td>
<td>—</td>
<td>12.1</td>
<td>13.6</td>
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<tr>
<td>Consumer price index for industrial workers</td>
<td>—</td>
<td>13.6</td>
<td>13.9</td>
</tr>
<tr>
<td>Exports at current prices&lt;sup&gt;c&lt;/sup&gt;</td>
<td>—</td>
<td>9.1</td>
<td>-1.5</td>
</tr>
<tr>
<td>Imports at current prices&lt;sup&gt;c&lt;/sup&gt;</td>
<td>—</td>
<td>13.2</td>
<td>-19.4</td>
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*Notes: a) At 1980-81 prices, b) 1981-82 = 100, c) in US$*

*Source: Government of India, Economic Surveys, various volumes.*

India’s economic performance, while a definite improvement over that in the pre-independence period, is less than satisfactory whether one takes the capitalistic index of growth rates of income or the socialist indices of eradication of poverty and reduction of income in-
equality. However, these seemingly low growth rates represent a notable acceleration over the annual growth rate of the British India for the first half of the twentieth century, which has been estimated at no more than 1 percent and compare very favorably with the growth rates of the presently advanced countries during their earlier development history. Decomposing the overall growth rate of the Indian economy into different sectors, the agricultural production increased at an average annual rate of 2.6 percent during the period 1950-90, while for the year 1991-92, agricultural production registered a decline of about 2.8 percent. The annual growth rates for food items and foodgrains during 1950-90, were in both cases also 2.6 percent. Again, with an increase in population of 1.9 percent per annum during these four decades, these growth rates in agricultural production seem trivial. In the production of foodgrain, the annual growth rate before independence was merely at stand still level of 0.1 percent. This static output of foodgrain during the pre-independence period, resulted in decline in per capital availability of foodgrains from 200.2 kg per year in 1905 to 152.2 kg during 1945-46. In the industrial sector, there has been considerable progress in the provision of infrastructure and basic industries. High rates of growth have been achieved in mechanical engineering, electrical engineering and chemical and allied industries. While the general index of industrial production (1950 = 100) increased from 139 in 1955-56 to 320.0 in 1965-66, the index for most basic key industries registered increase\(^2\) to 1150 during the same period. While India has still a long way to go to develop infrastructure and basic industries sufficient to meet the increasing demands of a growing economy, the progress in production of infrastructure has been spectacular.

India has had great success in achieving a significant level of self-reliance in basic industries; most consumer goods and food and certain raw materials including staple cotton. Attempts to achieve self sufficiency, particularly in basic industrial products, might have created some inefficiencies by establishing a high cost industrial structure. However, these policies, on the balance and in the long run, have greatly assisted India to produce industrial goods cheaper and generate basic industrial capacities which are prerequisite for growth in other sectors. Also policies aiming at self reliance have assisted in reducing the vulnerability of the Indian economy to International pressures and disturbances.

\(^2\) Government of India: *Third Five Year Plan*, 1960, p. 64.
III. The Economic Crisis 1991

In the background of growth in the macro variables of GDP, agricultural and industrial output, serious problems, however started emerging in the economy by 1990-91.

The budgetary situation became precarious from the widening budgetary deficits. Up till 1978-79, there was practically no revenue deficit in the Central Government budget. In fact during 1975-76, there was surplus on the revenue account. From surplus of Rs.887 crore in the revenue account in 1975-76, the deficit shot up to Rs. 18562 crore during 1990-91. In terms of its ratio to the GDP, the revenue deficit, which stood at only 0.6 percent in 1980-81, increased to a high figure of 3.51 percent during 1990-91.\(^3\) The overall budgetary deficit also increased from Rs.366 crore in 1975-76 to Rs.10772 during 1990-91. The huge deficit in revenue account was caused by relatively greater increase in total current expenditure, which increased from 10.9 percent of GDP in 1980-81 to 14.2 percent during 1990-91 (i.e. 50 percent increase over the decade) against the corresponding 21 percent increase in total current revenue.\(^4\) Also, the increase in current expenditure was mainly on such unproductive items as interest payments on mounting public debt, subsides and defense. This alarming increase in budgetary deficit has had highly unfavorable impact on the Indian economy in several ways such as increasing debt burden and vicious circle of deficit and — borrowing: A debt trap situation.

The increasing budget deficit also strengthened inflationary trend with all the consequences. The Indian economy has been facing a massive increase in general prices particularly since the sixties. The consumer price index (1960 = 100) registered an increase of 6.2 percent during the 1960's 8.5 percent during the 70's and 10.2 percent during the eighties. There was further increase in prices to 16.7 percent in August 1991. Similar increase was noticed in wholesale prices, which shot up by 13.6 percent in 1991-92 as against 9.2 percent in 1989-90.\(^5\) Examining prices of different groups of commodities, we note that the increase in food articles, were particularly high; 20.9 percent during 1991-92 as against the overall increase of 13.5 percent in prices of all commodities during the same period.\(^6\) This caused grave hardship to

\(^3\) Economic Survey 1992-93, p. 22.
\(^4\) Ibid., p. 22.
\(^5\) Ibid., p. 84.
\(^6\) Ibid., p. 82.
average families and particularly weaker sections, whose real incomes rather fell during 1990-91. The double digit inflation since 1992, has been caused by various by factors e.g. growing deficits as mentioned earlier, price distortion in industrial goods, expectations of higher commodity prices.

The year 1991-92 also faced a precarious situation in the balance of payments situation. Although India had deficit in balance of payments earlier during the Second and Third Five Year Plans, the magnitudes of the imbalance and some of its features including method of financing the deficits, however assumed serious proportions. The deficit in balance of payments which stood at 1.2 percent of the GDP in 1980-81, increased to the corresponding figure of 2.6 percent in 1990-91.7

Earlier, and particularly before 1980, India depended largely on official development assistance to supplement domestic investment. The inflow of the official development assistance, however, declined perceptibly during 1990-91. Greater reliance thus was placed on commercial borrowing carrying higher interest rates and more borrowing from the — International Monetary Fund (IMF) and deposits from the Non-Resident Indians (NRIs). These massive amounts of external borrowing and that also at higher interest rates, resulted in big increase in the magnitude of external debt of India; 21.4 percent of the GDP in 1990-91. The cost of commercial external borrowing increased from 2.5 percent in 1970 to 6.4 percent in 1989. The debt service as percent of current receipts reached a high figure of 24.7 percent in 1990-91 from the earlier estimate of 9.3 percent during 1980-81.8 The amount and certain other features of the deficit in the balance of payments, assumed such a serious proportion that India had to face some embarrassing situations. She was placed on credit watch by well known international credit agencies: Moody’s and Standard and Poor. It became increasingly difficult to have access to international credit markets and created loss of confidence in government’s ability to tide over the crisis in balance of payments.

In June 1991, India was on the brink of default in her international obligations with all the attending serious consequences. India had to pledge a part of the official gold reserves with the Bank of England, by shipping 46 tons of gold to U.K. from the monetary reserves of the Reserve Bank of India in July 1991 as security to gain confidence of

7 Ibid., p. 96.
8 Ibid., p. 118.
the creditor countries and financial institutions. By June 1991 the foreign exchange reserves fell to a dismally low figure of Rs.2383 crores (US$1.1 billion), which were barely enough to finance two weeks of imports. During the six months period of August 1990 to Feb. 1991, foreign exchange reserves fell by 61 percent and the situation became rather grave.

IV. Government Response to the Economic Crisis

Some of the above dangerous signals in the national economy prompted the Indian Finance Minister to acknowledge in his budget speech in July 1991 that his government, "inherited an economy in deep crisis." He showed grave concern on the fast deteriorating situation and expressed the view, there is no time to lose. Neither the Government nor the economy can live beyond its means year after year. The room for manoeuvre, to live on borrowed money or time, does not exist anymore. Any further postponement of micro-economic adjustments, long over due, would mean that presently difficult balance of payments situation, now exceedingly difficult would become unmanageable and inflation, would exceed limits of tolerance. He called for necessary sacrifices from the countrymen to preserve country's economic independence and restore the health of the national economy by resorting to some drastic steps including U turn changes in economic policies.

V. New Economic Policy

The various elements of the New Economic Policy announced during 1991 onward,\(^9\) can be classified under: (i) Stabilization Policies: set of short term measures to tide over the budgetary problems and the balance of payments crisis. (ii) Structural Adjustment: policies aiming at reforms in trade, industrial and public sectors.

A. Stabilization Policies

1. Fiscal Correction

An important element in the stabilization efforts was to restore

fiscal discipline. The government has set before itself the medium term objective of reducing substantially the central government fiscal deficit to about 3 to 4 percent of GDP. The government expenditure is to be reduced through slashing subsidies on exports and fertilizer as well as the steps to be taken to keep non-plan expenditures: for example defense expenditure, in check. The Central Government budget for 1992-93 has carried forward the fiscal adjustment program with the overall deficit to decline to 5 percent of the GDP.10 Apart from reduction in the government expenditure, additional tax revenues will be raised through comprehensive tax reforms including simplification and rationalization of the tax structure and also widening its base.

2. Balance of Payments Financing

Expecting that the above measures of fiscal correction and structural reforms will bring about an improvement in the balance of payments in the medium term, some short run steps were taken for financing of substantial balance of payments deficit facing the country. As already stated, the government sought support from international financial institutions, IMF, the World Bank and from bilateral donors. In July-September 1990, India withdrew the reserve tranche (RT) of the SDR 490 million. In December 1990, the government applied for the first credit tranche (FCT) of SDR 552 million and negotiated draws under the contingency compensatory finance facility (CCFF) which totaled SDR 1.352 billion between January and September 1991.11 In addition, India had drawn a total of SDR 270 million under the upper credit tranche stand by arrangement and further SDR 461 million was to be disbursed in April 1992. A Structural Adjustment Loan of $500 million negotiated with the World Bank of which $300 million had been withdrawn. Additional short-term loan was to be attained from the Asian Development Bank and other bilateral donors. Further steps to supplement balance of payments financing: The floating of the India Development Bonds directed at Non-Resident Indians and the Immunity Scheme for funds held abroad, were taken. The India Development Bond mobilized 1.6 billion, and the Immunity Scheme $793 million by March 1992. India continues to negotiate more funds from the World Bank, IMF and other international financial institutions. As in December 1992, India has received loans and credit of over $35 billion from the World Bank alone, making her one of the largest borrowers from the World Bank Group. The total outstanding exter-

nal debt of India increased from $20 billion in 1980-81 to $71.5 billion in 1991-92: a massive 257 percent increase during a decade.\textsuperscript{12}

For lasting solution of the balance of payments problem steps would be planned for substantial improvements in country’s export performance. During the coming 4 to 8 years period, however, some adjustments are called for: (1) Reduction in domestic excess demand through anti-inflationary fiscal and monetary policies. Care will, however, be taken to ensure that any reduction in aggregate demand is brought about without hurting production and it is shared by different economic classes in the country. (2) Enhanced Competitiveness: through change in the exchange rate of the rupee: 18 percent downward adjustment in the external value of the rupee in July 1991, phasing down of import restrictions and reduction in high level protection. Further reduction in exchange rate of rupee against US Dollar was announced in December 1992. (3) Simplification of administrative procedures governing controls over imports and exports including custom procedures. Trade and customs classification of goods were harmonized in October 1991. Further steps were taken to simplify administrative procedures to make international trade as easy as domestic trade. (4) Increase technological and managerial capability for self-improvement to compete in world market for India’s agricultural and industrial products.

3. Monetary Reforms

The long-term objective of the monetary policy would be to promote operational efficiency of the financial system and develop the money market. Simultaneously, steps will be taken to support the cohesive package of measures of macro-economic stabilization and structural reforms initiated by the government as a part of the New Economic Policy. Credit Policy measures include the following: First, for import containment through non-discretionary measures, cash margins will be imposed and also cost of import finance will be increased through the imposition of a 25 percent interest rate surcharges. Secondly, tight money and credit regime will be adopted to contain the current account deficit on the balance of payments and reduce fiscal deficit. Thirdly, new monetary instruments: 364 days Treasury bills, and 15 year and 10 year dated securities, all on auction basis, have been introduced for reforming the financial sector and meeting government’s increasing financial needs from the government securities

\textsuperscript{12} World Bank, \textit{World Debt Tables} 1992-93.
market. The further rationalization of lending rates and substantial freedom given to banks to determine deposit maturities and deposit rates also constitute a part of the reform program.

B. Structural Adjustments

These policies include various measures aiming at structural reforms in trade, industrial and public sectors. The objective is to increase competitive strength in the industrial economy: Evolve an industrial and trade policy framework to promote efficiency, reduce the bias in favor of excessive capital intensity and encourage an employment oriented pattern of industrialization.

1. Trade Policy Reforms

These reforms intend to create necessary climate to stimulate exports and reduce the degree of regulations and licensing control on foreign trade. The exchange rate adjustment of 18 percent in the value of rupee was made to provide stimulus to exports.

(i) A large part of the administered licensing of imports was replaced by import entitlement linked export earnings. These import entitlement renamed Eximscrisps would be freely tradable and attract a premium in the market. Most exports can be traded at the rate of 30 percent of Eximscrisps but in case of some exports the rate was higher.

(ii) Eximscrisps could be used to import any item from among the permissible list, the non-canalized list, all Open General License (OGL) items for actual users and non-OGL capital goods which were not in the restricted list.

(iii) The advance Licensing system for export was simplified so as to improve exporters' access to imported inputs at duty free rates.

(iv) Permission to import capital goods was given without clearance from the indigenous availability angle provided this import was fully covered by foreign equity or was up to 25 percent of the value of plant and machinery, subject to a maximum of Rs.2 crore.

(v) Export and Trading Housing and Star Trading House were permitted a larger range of imports. 51 percent foreign equity is also now allowed in Trading House.

(vi) The scope of canalization for both exports and imports was narrowed.
(vii) Actual user requirements for the import of capital goods, raw materials and components under OGL was removed; and

(viii) Established exporters are now permitted to maintain foreign currency accounts and to raise external credits to finance their trade transactions.

2. Industrial Policy Reforms

In order to consolidate the gains already achieved during the 1990’s, and to provide greater competitive stimulus to the domestic industry, a series of reforms were introduced in the Industrial Policy. The new industrial policy of 24 July 1991 sought substantially to deregulate industry so as to promote the growth of a more efficient and competitive industrial economy. Industrial policy reforms announced in July 1991 should be seen as being complementary to those undertaken in trade and fiscal policies and in the management of the exchange rate and the financial sector. The central elements of these reforms were as follows:

(a) Industrial licensing was abolished for all products except in 18 industries where strategic environmental concerns are paramount or where industries produce goods with exceptionally high import contents. With this, 80 percent of industry has been taken out of the licensing framework.

(b) The Monopolies and Restrictive Trade Practices (MRTP) Act was amended to eliminate the need for prior approval by large companies for capacity expansion or diversification. This will enable Indian firms to become large enough to compete effectively in global markets.

(c) The requirement of phased manufacturing programmed was discontinued for all new projects.

(d) Areas reserved for the public sector were narrowed down, and greater participation by private sector was permitted in core and basic industries. In the place of the 17 areas earlier reserved for investment by the public sector, only 8 areas are now reserved. These eight areas are mainly those involving strategic and security concerns.

(e) Government clearance for the location of projects was dispensed with except in the case of 23 cities with a population of more than one million.
Small-scale enterprises were given an option to offer up to 44 percent of their share-holdings to large-scale and other industrial undertakings. This will provide them with greater access to capital and technology.

Loan agreements of the financial institutions with privately managed firms were earlier required to provide for the right of the financial institutions to convert the loans into equity. In August 1991, these institutions were permitted not to insist on this provision in future loans unless they felt it necessary for commercial reasons. In December 1991, the institutions were permitted to delete the provision from past-loans also subject to a revision of the interest rate where appropriate.

A National Renewal Fund has been set up with a corpus of Rs.200 crores to ensure that the costs of technological change and modernization of industry would not borne by workers. The Fund will be used to provide a safety net to workers in sick and nonviable enterprises, and to finance their retraining and redevelopment.

3. Inflow of Direct Foreign Investment

Along with a reform of industrial policies, steps were also taken to facilitate the inflow of direct foreign investment. These non-debt-creating inflows will reduce reliance on fixed interest debt and also bring in new technology, marketing expertise and modern managerial practices. The following measures were taken in this context:

(a) The limit of foreign equity holdings was raised from 40 to 51 percent in a wide range of priority industries. However, foreign exchange outflow on account of dividends on additional equity will be balanced by export earnings. Such foreign equity participation now has automatic approval and is cleared by the Reserve Bank of India.

(b) The procedures for investment in non-priority industries have been streamlined. The Foreign Investment Promotion Board (FIPB) has been established to negotiate with large international firms and to expedite the clearances required. The FIPB also considers individual cases involving foreign equity participation over 51 percent.

(c) Technology imports for priority industries are automatically approved for royalty payments up to 5 percent of domestic
sales and 8 percent of export sales or for lump sum payments of Rs.1 crore.

4. Public Sector Reforms

To enable the public sector to work efficiently, the public sector units have been given greater autonomy in their operations. A system of full responsibility and complete accountability will be enforced on public sector managements. In 1991-92, the Government undertook a limited disinvestment of a part of public sector equity to the public through public financial institutions and mutual funds in order to raise non-inflationary finance for development. The disinvestment will also bring in greater public accountability and help to create a new culture of operational efficiency in their working. Recognizing that sickness is a serious problem in many public sector units, the government amended the Sick Industrial Companies Act to bring public sector undertakings also within its purview. This makes sick public sector units subject to the same discipline as private sector units including reference to the BIFR for identification of a viable restructuring package or closure as the case may be.

After the announcement of New Economic Policy in 1991, the Government of India submitted a memorandum in June 1992 supplementing and/or modifying the earlier announced conditions and policies outlined above. On the basis of this memorandum, the IMF agreed to release the bulk installment of $2.2 billion into an Enhanced Structural Adjustment Facility by November 1992. Some important provisions in the Memorandum are (i) The rate of growth of inflation has been set at 8 percent for 1992-93 against 6 percent targeted earlier. (ii) Government to refrain from imposing new restrictions on imports as well as on payments and transfers from the current international transactions during the program. (iii) Government will intensify the process of liberalization during 1992-93 through (a) to enhance government tax revenues by broadening the base of indirect taxes and gradually to move towards system of value added taxation, (b) the disinvestment program of public sector will be extended in 1992-93 with several units going beyond 20 percent and up to 49 percent. The disinvestment policies to include sale of shares to workers and new scrips offerings on the stock market.

On September 14, 1992, Government of India announced permission to Foreign Institutional Investors (FII) such as pension funds, mutual funds to invest in all the securities traded on the primary and secondary markets, including the equity and securities/investments of
companies listed on the Indian Stock Exchange. These would include shares, debentures, warrants and the schemes floated by domestic mutual funds. It is hoped that this rather important step, would give boost to inflow of foreign capital and also mark a major step towards globalization of the Indian Economy.

All the above elements in new economic policies, are, in popular language, known as "liberalization," "privatization," "globalization," "deregulation" and "decontrols." Adoption of such policies has become rather common in most economies in the East and West, developed and developing and in market as well as in the erstwhile socialist economies. To some extent, adoption of such policies is explained by the ineffectiveness of the control regimes: growing losses in public sector, increasing intervention and participation by government in national economies, slow progress to achieve economic goals. The adoption of these policies has been required or emphasized by international lending agencies for example World Bank, Asian Development Bank, Inter-American Bank and some government donors such as US Aid Program. Recently, the biggest surprise has been the adoption of market oriented policies in the former socialist countries like China, Russian Republics (former USSR) and East European Countries. Presently the world economies are standing at cross-road; change over from the regime of state regulations and control to deregulation and decontrol; putting reliance on "Market Economy" away from "Regulated Economy." Though we do have the experience of some countries, particularly in Latin America, from having adopted some of these policies, the possible outcome in India is rather uncertain. As such, there is controversy on the advisability of making such a U-turn in economic policies. While some economists have hailed these policies as harbinger of economic growth by freeing economies from the "Shackles of Regulations and Controls," others have labeled them as misguided and dictated by international agencies dominated by Capitalist Superpower(s) to profit from the economic helplessness of developing countries. In an opinion poll recently conducted by a national daily: Times of India on the direction of government’s economic reforms, 41 percent expressed satisfaction while 50 percent said there was considerable room for improvement. Nine percent of correspondents had no opinion. Support for the economic reforms is higher among the upper income groups (45 percent) than among the less affluent (38 percent).13

13 Times of India, November 22, 1992.
VI. How Different is the New Economic Policy?

How is the New Economic Policy announced in 1991, different from series of policy announcements, made during 1970-90. In its Annual Report 1992 the World Bank, commenting on India’s New Economic Policy remarks, “During the short time that the current government has been in office, it has altered India’s policy framework perhaps more fundamentally than during the whole previous decade of gradual reform.”\textsuperscript{14} We tend to agree with this assertion and in many ways, the New Economic Policy 1991 has been a radical departure from the earlier policies framework. Some of the areas where one observes crucial changes are as below:

A. Comprehensiveness

The various policy announcements made during 1970-1990 carried few aspects only \textit{e.g.}, liberalization of imports, removing restrictions on the expansion of industrial houses under the MRTP Act and these were also made on piece meal basis. The New Economic Policy announced in 1991 is quite comprehensive covering wide range of aspects from industrial policy, trade policy to financial reforms and deregulation and decontrol of the economy. Also all components of the New Economic Policy take effect more or less simultaneously.

B. De-emphasis of Public Sector

The public sector which for more than three decades: since the Industrial Policy Resolution 1956: was emphasized as “Commanding Heights” has now been de-emphasized in several ways. There is, for example, a reduction in the number of industries reserved for the public sector from seventeen to eight. Also, some of the chronically sick public enterprises which are unlikely to be turned around by the Board for Industrial and Financial Reconstruction may be liquidated on the basis of their mandatory review. Moreover, the disinvestment of public holdings to the extent of 20 percent of some of the public enterprises would make these public enterprises subject to the discipline of market forces. All these provisions would erode the public character of the public sector.

C. Expansion of Existing Industrial Enterprises

Henceforth the economic philosophy has been the prevention of the concentration of economic power in private hands through the MRTP regulations. The MRTP Act will now be amended to remove the threshold limit on assets of large industrial houses. This step is likely to extend the size of large enterprises and make them more diversified to compete effectively in global market.

D. Market Approaches Orientation

Market forces as allocator of resources amongst various industries and determinant of what and how to produce, will now take place of the old regime of regulations and controls. The easy entry of foreign private direct investment to the extent of majority ownership would also strengthen the market-related competitive forces. Limiting the public sector to smaller number of industries will also increase the area of operation for private enterprises.

E. Globalization of the Economy and Outward Looking Orientation

The Indian economy has been wide opened to foreign institutional investors, e.g. mutual funds, and pension funds. It will bring the Indian domestic market nearer the world markets. The multinationals would be expected to bring into India latest technology, technical know-how, marketing techniques and management practices. With the removal of protective tariff walls, the Indian enterprises will be forced to improve their products to compete in world markets. The Indian economy will become more open with changes made in the areas of foreign exchange rates, trade and fiscal affairs including devaluation, part (later complete) convertibility of rupee, and free import of goods and services. The economy will become outward rather than inward looking as in the past.

F. Pragmatism as Basis of Economic Policy

India’s Socialistic Pattern of Society, as the basis of Indian economic planning, had some elements of ideological bias as clearly implicit in Prime Minister Nehru’s famous statement: “The picture I have in mind is definitely and absolutely a socialistic picture of society.” In the New Economic Policy, the guiding force in the allocation of resources between public and private sectors, will be efficiency — a pragmatic approach to maximize industrial growth.
G. Addition to Resources

India has hitherto suffered from the lack of investment funds particularly foreign capital. The opening of Indian Stock market to foreign institutional funds will hopefully bring in large amount of funds which would be invested in expansion of the economy. Previously India had to incur huge interest costs to borrow funds, now the investment funds will flow into the Indian economy to participate in profit from growth in the economy.

VII. Some Comments on the New Economic Policy

Indian economy, after opening up as implicit in the New Economic Policy and with the infusion of massive amount of foreign capital from IMF, friendly donor countries, NRI’s, multilateral institutions and foreign institutional funds, would, in the view of a World Bank official, be making steady progress in its bid to rival — the “tiger” economies of East Asia. She would be on her way to become an Asian Tiger itself through the new economic policies and reforms already under way since 1991. The Indian Finance Minister addressing a meeting of NRIs in London on September 17, 1992 on the New Economic Policies painted the picture of a golden dawn in which India will awaken to find the rupee convertible, exchange controls gone, import duties and corporate taxes and inflation reduced and foreign investment enhanced. These “policies of liberalization” in the word of Finance Minister, “would turn India into a major power.” Will this grand hopes materialize, of course, would depend on the expected positive results of various policies.15

In order to comment on some aspects of “the New Economic Policy,” it will be useful to recapitulate the main economic problems which, as viewed by the government, led to the adoption of these measures on crisis basis:

1. The import compression proved counter productive as tool for improvement in serious balance of payments problem, threatening possible default of the international debt.

2. Protection given to Indian industries created sheltered domestic market not encouraging quality improvement to compete in the world markets. Hence India could not diversify her exports

15 Times of India, September 17, 1992.
beyond the few traditional items.

3. Cumbersome administrative procedures on import, exchange control, regulations etc. stood in the way of expansion and improvement of enterprises and economic growth.

4. The public sector did not contribute to the expected level of public savings and rather swallowed large amounts of public funds to cover huge losses from inefficient operations.

5. Excessive government expenditure from many causes including various types of government subsides, caused fiscal imbalance in revenue accounts, leading to inflation and balance of payments problems.

A. Postulates and Assumptions

As we have already discussed, the New Economic Policy has two main components: a) Short-run corrections and Long-term structural changes. These policies are based on following assumptions and postulates which have been taken as axiomatic and articles of faith.

1. Text book argument that devaluation will increase our exports and discourage imports from adjustments in the value over valued rupee.

2. The fiscal imbalance will be corrected by removing subsides, scaling down of other government expenditures and increased revenues through tax reforms.

3. Deemphasizing the inefficient and promoting private enterprises, will make the overall economy more efficient.

4. Market mechanism will bring about better allocation of resources and make the economy more efficient.

5. Reducing import duties, removing barriers to the entry of foreign capital will bring in large amounts of foreign funds and modern technology. This will enhance investment, growth and global competitiveness of Indian exports.

6. The benefits from economic growth in the industrial sectors will trickle down to the other sectors of the economy and sections to weaker sections of the society.

7. Privatization and adoption of competitiveness as an economic philosophy will also spread to other sectors of the country such as education, public health, communications.
B. Was the New Economic Policy Adopted in Panic? Was There an Alternative?

The Government of India maintains that it had to resort to these radical steps to save the country from financial disaster and to avert the exceedingly difficult situation facing the country. A review of the state of the Indian economy mentioned earlier suggests that, in one way, the decade of the eighties was a period of high growth in GDP and also in the agricultural and industrial sectors. During 1980-90, the GDP both at the current and at 1980-81 prices increased at annual compounded growth rate of 14.4 percent and 5.5 percent respectively which are the highest rates since 1950-51.16

During the same period, the average annual gross domestic savings rate stood at 21 percent of the GDP at current prices, which again is the highest since 1950-51. It is true that the economy faced higher rate of budget deficit in the current account in balance of payments: 2.5 percent of the GDP during 1990-91 against the average corresponding figure of 2.2 percent during 1985-90 and the foreign exchange reserves fell to a low figure of $2,152 million in December 1991.17 However one should note, that India has had a chronic adverse balance of payments and foreign exchange reserves had also hit low points before several times e.g. during 1981-82. Nor it is for the first time that India had budget deficit in 1990-91. She had budget deficits of 2.0 and 2.8 percent of the GDP earlier too: e.g. during 1985-86 and 1986-87. Inflation is also not a new phenomenon for the Indian economy. There has been double digit inflation also before e.g. 18.2 percent during 1980-81.

Looking at the data on same important variables, one would agree that the balance of payments and drawing down of the foreign exchange reserves situations became rather serious during 1990-91 also and there was difficulty in borrowing further from commercial sources. There is, however, still a question whether or not these problems could be dealt with by some other alternative rather than discarding economic policies embodied in India’s Five Year Plans. Up till 1980, India were offering with pride her development model of the mixed economy to Third World developing countries. Why then just a decade later she changed her course of action so dramatically particularly when she have had high growth rates in GDP and its components during the eighties? Do not societies face economic emergencies? After all countries do fight expensive wars and face destruction

but still they stand on their feet without unwarranted alarm. We hope that the Indian Government did not take these drastic measures in the state of panic and haste. One hopes that the implications of these drastic policies and also preconditions for their success have been carefully thought through including taking into account experience of other developing countries from identical policies also suggested to them by the World Bank and IMF. The rapidly with which these policies were announced cast some doubt on having careful and comprehensive deliberation on these policies before adoption.

As regards the question whether or not there was any alternative to the new economic policy measures. Of course, as stated above, the Indian Prime Minister asserted that there was no alternative, short of default on foreign debt with all serious consequences. The critics, however, suggest that the government pushed the panic button rather than considering adoption of alternative measures. Even if, there was need to approach the World Bank/IMF for loan to tide over the deficit in balance of payments, India could negotiate on conditionalities. After all, India did get loans earlier without adhering to most of these drastic conditions. Recently, China and Russia have resisted several similar conditions sought to be imposed by the World Bank. Further, the Government of India could adopt some emergency measures to deal with the balance of payments deficit. Let us not forget that India did achieve balance in foreign accounts successfully in 1974 after the first oil price hike. India could cut drastically import of oil and ration it (USA did so during 1973-74), tighten up and drastically prune other imports. Imports did not have to be opened freely at this juncture. The country could adopt a strict self-balancing mechanism to equate large part of India’s commercial imports to exports.

There is also a dire necessity of reducing aggregate demand by not only cutting unnecessary government expenditure, but also by curbing black money which is largely responsible for inflationary pressures, creating a wave of consumerism and demand for elitist consumer goods. Some such measures adopted on emergency basis, with strong political will, could create an economic climate of confidence in the seriousness of the Indian Government to deal with economic difficulties. It is contended by critics that the massive foreign borrowing and accepting the attached conditions, was the easy way out adopted by India’s soft state.

C. Devaluation of the Indian Rupee

It is questionable whether Indian rupee was indeed overvalued such
that it necessitated devaluation. During 1981-82, Indian rupee registered considerable exchange depreciation: Against the SDR, depreciation of the Indian currency was as high as 70 percent. According to another estimate, the index of real effective exchange rate of the Indian rupee fell from 100 in 1981 to 70 in 1989. During 1980-87, the cumulative depreciation of the Indian currency against US dollar was 47.8 percent against DK Mark 14.9 percent, pound (UK) 12.3 percent and Japanese Yen 58.1 percent. Since the Indian rupee has been experiencing defacto devaluation all through the 1980's and particularly since 1987, one could question whether the Indian currency was indeed overvalued and needed devaluation.

India's experience of earlier devaluation and defacto depreciation has been at best mixed. During 1966-67, the first year of post devaluation, imports increased faster than exports (45.5 percent and 38.5 percent respectively). On the whole, during the five-year period of post devaluation, imports and exports rose at an annual average rates of 6.6 percent and 13.1 percent respectively. However, the beneficial impact of devaluation seemed to have exhausted after 1970-71. During the period 1971-1991, exports as percent of imports fell from 83.3 to 67.2 and figure of trade deficit as percent of GNP registered an increase of 1.0 percent in 1971-72/1975-76 to 2.7 percent during 1986-87/1990-91. Also it should be noted that devaluation alone cannot reduce imports and encourage exports. Other factors e.g. domestic production capacity, foreign countries ability and willingness to absorb our exports, nature of demand for our exports and imports, are some of the principal factors. To a great extent, the present domestic and international conditions do not seem conducive to gains from devaluation. While there is great uncertainty about expected benefits from devaluation in India's balance of trade, however it is estimated that devaluation will increase the rupee value of her foreign debt. (from 38 percent of national income in June 1991 to 47 percent after July 1991 devaluation), the debt service ratio from 26.3 percent to 58.0 percent in 1991-92. Devaluation will necessitate raising the volume of exports by 23 percent just to keep the earnings in dollar terms at the constant value. It can bring about any benefit only after

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18 Calculated from data in Reserve Bank of India Bulletins various issues. Also see S. Krishna Rao, External Crisis, Sweeping Changes in Macro-economic Policies and the Union Budget in P.C. Jain, edit India's Economic Crisis: Diagnosis and Treatment, New Delhi concepts publishing company, New Delhi, 1992, pp. 192-195.


adjusting for this compensating volume of increase in exported goods and it is doubtful whether the export volume would increase beyond this 23 percent figure. It seems that the expected gains from devaluation of Indian rupee are highly questionable.

D. Balance of Payments Position

As stated earlier, the main motivation to adopt the new policy measures was to deal with the balance of payments crisis faced in 1991. In the short run, the crisis was averted by — massive amount of loans from the World Bank, IMF etc. but in the long run, the solution was sought to be improved by stimulating exports and curtailing imports through various measures: (a) Devaluation, (b) making the Indian products more competitive by cost reduction measures through technology improvement, modernization of plant/equipment by foreign firms to enter Indian market, (c) internal competition achieved through internal and external competition between firms from removal of barriers to entry, deregulation and decontrol.

It is true that India has averted the balance of payment crisis in the short run, but, as stated earlier, one is skeptical about the effectiveness of devaluation as a measure to stimulate exports and curtail imports over the long period. The problem would also be accentuated from increase in burden of external debt due to upward adjustment in its value as stated above. To what extent the multinationals will establish enterprises in India, bring new technology, and export their products are matters so far fetched that one cannot even visualize any result at this stage. It may take several decades for Indian domestic industries to become more efficient through competition both in domestic and foreign markets and achieve desired results in export promotion. In this connection, we wish to make two points. Firstly, the question of entry of multinationals in any economy is rather a complex question. Lower costs and higher returns, though important, may not be sufficient inducements. Other factors such as the political climate in a country including the free hand the multinationals expect in operating their enterprises without critical scrutiny from local sources, political stability, reasonable consensus on question of vital political and economic issues are also crucial. One wonders whether India has or would have such a political climate in foreseeable future. In India, foreign investors are easily frightened by political unrest and riots like the ones that recently occurred all over the country following the demolition of Babri Mosque. The continuing political troubles in Punjab, Kashmir and Assam easily shake their confidence in the country's political
stability. In India, there exists well established tradition of critical evolution and free expression of ideas which sometimes are irksome to foreigners particularly foreign investors, Many a time, the foreign operations do not measure up to Indian perceptions of fairness justice and equity. The recent cases of India’s dealing with IBM, Coca Cola and even Union Carbide are still fresh in the minds of multinationals. The relaxation of restrictions implicit in MRTP Act, in fact, may promote monopolistic practices on the part of large business houses.

E. The Distribution and Equity Aspects

Although the Government of India assured that people’s basic needs would be met and distress prevented, an analysis of various policy measures suggest that poverty alleviation would be left to “trickle down” effects from industrial development and economic growth of the economy. The new economic policy is silent on dealing with weaker section of the population such as marginal farmers, agricultural laborers and unskilled workers in the urban informal sector.

In the emerging economic climate of market mechanism guiding nation’s social and economic problems, government will not be taking dominant role in the redistribution of income. Whatever progress has occurred in India in the matter of poverty alleviation since planning, has been through several government programs such as employment guarantee schemes, intensive agricultural development program, public distribution system, assistance to cottage industries. It is well known that market forces left to themselves, are not able to tackle problems of poverty and unemployment particularly in traditional family oriented agriculture and informal urban sector. In the market economy, with highly skewed distribution of income nation’s resources will flow to satisfy the insatiable demands of elitist consumer groups. One would expect expansion of industries and imports to meet demands of upper income brackets rather than producing wage goods to satisfy the basic needs; thus further accentuating income inequalities and make life harder for poor.

With the market approach applied to other aspects of society as well such as education, public health and provision of other basic services, India would be moving towards creating “Two India’s”: One for well offs: say upper 20 percent and the other for the remaining 80 percent folks. It has already happened in the provision of education facilities. Children of well to do’s go to privately operated schools with English as medium of instruction providing better standards and facilities. Children from lower income classes, on the other hand, have
to go to sub-standard government schools which are deteriorating due to lack of funding. Those who can afford expensive “speed post” and fast developing private operated courier services, their mail will be delivered fast, otherwise one would be using deteriorating public mail system. Poor go to crowded and poorly equipped hospitals, while those with money can take advantage of expensive but good private health facilities developing all over the country. These economic disparities and social distinctions go against Indian’s declared objective of egalitarian society promising more equal opportunities to masses.

F. Monopolies and Concentration of Economic Powers

The removal of threshold limits on the assets of large industrial houses through amendment in MRTP Act, is assumed to achieve economic efficiency, presumably by reducing unit costs from economies of scale. Several implication of this measure seem to have been ignored. Firstly expansion of the large houses will enhance the concentration of economic power which is clearly contrary to the avowed objective of reducing economic power in the industrial and business structure in the country. Secondly, the expected expansion in the size of industrial houses will increase monopolistic trends, adversely affecting the competitive climate which the new economic policies expect to usher in. Thirdly there is need for comprehensive studies of the cost structure of large industrial houses before assuming that their expansion will reduce unit cost through economies of scale.

G. The Neglect of Agriculture

In the New Economic Policy, agriculture and allied activities which still employ 70 percent of India’s population and absorber of expanding population, is not receiving the attention it deserves for investment particularly in infrastructure and improved technology. Private investors, both foreign and domestic, are not likely to find investment in agricultural infrastructure feasible and attractive. The New Economic Policy does not address to the major problems confronting agriculture such as low productivity in small and scattered marginal farm holdings, lack of rural credit. To the extent, agriculture does not produce the needed output to meet the increasing demands, the gap in wage goods will grow. The gap in the agricultural and non-agricultural incomes and also terms of trade between the two sectors will grow further for majority of the population.
H. Inflow of Foreign Capital

Great emphasis has been placed in various economic policy measures on the inflow of massive amount of foreign capital in various forms. While the Government of India is very optimistic about the inflow of large amounts of foreign capital, there seems to be undue over optimism on several accounts. According to a report of the Federation of Indian Chamber of Commerce and Industry while the Government of India approved foreign investment of $1.4 billion during 1992, the actual inflow has been only $200-300 millions.\textsuperscript{21} We have already expressed skepticism on the question of increasing net export earnings. The foreign investments and also the inflow of capital from foreign institutional funds are also overestimated. The mere raising the limit on equity holdings for foreigners, delicensing and decontrol and partial convertibility of Indian rupee are not sufficient conditions to attract foreign capital. The political climate particularly political stability, national consensus on policy towards foreign capital are also important matters for investors before they risk their capital. Also, most developing countries with equally abundant labor and raw materials have adopted economic measures similar to ones adopted in India.

There are huge demands for foreign capital in the former USSR republics and East-European countries. In addition to severe competition that, India has to face for foreign funds from other developing countries, the world trade has shrunk due to recessionary economic climate. Advanced countries e.g. USA, UK, Canada are adopting protection measures to stimulate their depressed economies. Then, there are several bilateral and multilateral trading blocks being formed which will be difficult for developing countries including India to penetrate into for exports. Even if the expected amount of foreign capital becomes available, there still remains the question of absorptive capacity of the Indian economy. India’s record of utilization of the authorized external assistance is not very — promising. The utilization of aid rate during 1985-1991 has been only 50.5 percent due to poor economic management and administrative bottlenecks.\textsuperscript{22} To the extent, the estimated foreign capital is not forthcoming and or not utilized, the economic calculations and targets implicit in the New Economic Policy would be adversely affected.

I. The Unemployment Problem

\textsuperscript{21} Times of India, November 23, 1992.
\textsuperscript{22} Compiled from Economic Survey 1991-92.
The Indian economy suffers from serious unemployment and underemployment problems. The recent trends of both the magnitude and nature of unemployment are rather disturbing. Firstly, overall growth rates of employment are decreasing steadily over time. Secondly, with the acceleration in the rate of growth of GDP, the employment growth has not shown increase, rather it has been significantly lower than the growth rate of population and labor force. Another disturbing feature has been the absence of growth in employment in the organized manufacturing sector. These and other factors have led to an increase in open unemployment as compared to the massive historical underemployment (including low productivity employment) in India. Thus, the shift from underemployment including disguised unemployment to open unemployment clearly has serious socio-economic implications. It is feared that various measures implicit in the New Economic Policy, such as Exit policy and deinvestment in public sector, growth of industrial sector with capital intensive modern technology, decrease in government expenditure to reduce fiscal deficit, are likely to accentuate the problem of unemployment at least till their trickle down effects are felt in any foreseeable future. According to the 1990 estimates in the Eighth Five Year Plan, the labor force will increase by about 37 million during 1990-95 and by another 41 million during 1995-2000. Taking into account the present back log of unemployment (34 million open unemployment 1990) jobs to the order of 71 million will have to be created if unemployment problem has to be dealt with by 1995.23 New employment opportunities to the order of a staggering figure of 112 million will have to be generated if unemployment problem has to be solved by the end of the century. The New Economic Policy not discus this rather grave issue with the amount of seriousness that it deserves.

J. Political Aspect of the New Economic Policy

The enthusiasm with which the New Economic Policy will be accepted and implemented will also be determined by political pressure groups affected by its various provisions. Earlier, political and economic power rested with bureaucrats, big land owners, big business and organized labor. This grouping will now be altered with new losers and winners. The New Economic Policy measures reduce the role and power of bureaucrats from deregulation, decontrol and deemphasis of public sector. Organized labor will be loser from “privatization” and

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exit policy implicit in reorganization of public sector and massive lay offs from reduction in government expenditure. Big land owners have lost handsome subsidies on fertilizers and reduced procurement prices for their products. Presently happy with the new economic policies are big businessmen who will have freer hand in their business operations without facing the ordeals of obtaining licenses and regulating procedures. Whether or not the Indian businessmen will be happy in the long run with — competition from foreign firms and multinationals, who have been encouraged to invest in India, remain to be seen. Indian business would have been happy with deregulation and decontrol but in the protected domestic market. How will they will react when faced with competition from products from foreign enterprises with superior infrastructure, and modern technology, remains to be seen. Other groups which will be winner in the new economic climate would be management personnel in big private enterprises, stock brokers, consultants and other professionals. They will constitute New Yuppies or elite class in India. The large masses in India’s populations in agriculture, small scale and cottage industries will, at least in the short run, find themselves at comparative disadvantage. The opposition parties will gear themselves to vent frustration of economically disadvantaged teeming millions. Powerful political interest groups losing from the New Economic Policy will resist its adoption. Presently the political situation in India is too fluid to make any reasonable prediction till the new economic policy measures have time to be implemented and shown their effects.

K. The Role of the Planning Commission

India will need to reconsider the role of Planning Commission in the context of the New Economic Policy. The Planning Commission has so far been functioning as an apex economy body directing allocation of national resources with reference to the goals of economic policies implicit in Five Year Plans. Now that the allocation of resources will be largely determined by market forces, the function of the Planning Commission will need to be redefined. In our view the Planning Commission should be concerned with the development of those sectors in the national economy which, as stated earlier, stand neglected in the New Economic Policy. It should also deal with problems of poverty and unemployment which have been largely left ignored till the “trickle down” effect of various economic measures, occurs.
VII. Summary and Conclusions

The New Economic Policy, July 1991, was a U turn in the Indian economy. In place of the hitherto planned economy, India has adopted market oriented strategies to deal with her massive economic problems. The New Policy contains (a) short run fiscal corrections: massive external borrowing, devaluation the Indian rupee, cut in government expenditure and (b) structural adjustments: deemphasis on public sector, deregulation, decontrol and privitization of enterprises. The New Policy is justified by the government on account of the failures of old economic policies to promote economic growth, inability of the public sector to generate profits for planned industrial development and most importantly, budget deficits, inflation and serious balance of payments problems. The government has borrowed massive amounts from (a) International agencies: World Bank, IMF (b) Non-Resident Indians and (c) Commercial sources to cover deficit in balance of payments. The Indian Rupee has been devalued to stimulate exports and reduce imports, deemphasis on the public sector, deregulation and decontrol would hopeful stimulate private investments and make the industrial enterprises more efficient. The government expenditure has been reduced particularly cutting subsides, and tax structure reformed to raise additional tax revenues to cover budget deficit and ease inflation. The government contend that there was no alternative but to adopt the New Economic Policy measures. The critics, however, feel that the government pushed the panic button when faced with deteriorating balance of payments, budget deficit and double digit inflation. The critics contend that rather than making the U turn in economic policies, stringent imports controls, fighting the menace of black money to ease inflation, and raising additional tax revenues through tax reforms, the government yielded to World Bank conditions in hurry to borrow massive funds.

Whether or not the New Economic Policy measures would achieve the desired results would depend largely on some crucial implic assumptions and postulates particularly the effect of devaluation on foreign trade and foreign investments. We free that since the demand for India's imports is generally inelastic and her exports have rather weak demand abroad for most commodities, devaluation is not likely to correct adverse balance of trade. Further, since India's export competitors have also adopted measures similar to the new Indian economic policy and the world economies are depressed, there is not much hope for any accelerated growth in India's exports. Rather, devalua-
tion will raise the rupee value of India’s external debt and also the debt service burden. Whether the foreign companies will be attracted to invest in India, to modernise and globalisation, of the Indian industry, would rather depend on various factors including political stability. The mere deregulation, decontrol and raising the ratio of equity holdings will not be enough. So far India has not been able to attract expected large amounts of foreign investments, though there have been many enquiries in this connection from foreign investors. If the expected amount of foreign investments do not materialize and the balance of payments do not improve, the desired goals of the New Economic Policy are not likely to be achieved. Furthermore, the New Policy ignores the serious and deteriorating unemployment problem, income inequalities and mass poverty except hoping for the trickle down effects of private and foreign industrial investments. The agricultural sector which still employs 70 percent of the work force and continues to be mainstay of the national economy, has not received the needed attention in the New Economic Policy. Overall, the outcome of the New Economic Policy seems uncertain at least in the short run.

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